RECEIVED
MAY 09 2002
ILLINOIS COMMERCE COMMISSION
CHIEF CLERK'S OFFICE

MEMORANDUM

TO: Chairman Richard L. Mathias
Commissioner Terry Harvill
Commissioner Edward Hurley
Commissioner Ruth K. Kretschmer
Commissioner Mary Frances Squires

FROM: Eve Moran and Phillip Casey, Administrative Law Judges
Assisted by: Dan Paulsen, Legal Extern

DATE: May 7, 2002

SUBJECT: Illinois Bell Telephone Company

Application for review of alternative regulation plan.

Illinois Bell Telephone Company

Petition to Rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates.

Citizens Utility Board and The People of the State of Illinois
-vs-
Illinois Bell Telephone Company

Verified Complaint for a Reduction in Illinois Bell Telephone Company's Rates and Other Relief.

Re: Commissioner Squires' questions.

DISCUSSION

The ALJs do here respond to the questions pertaining to Docket No. 98-0252/98-0335/00-0764 (Consol.) as set out by Commissioner Squires.

1) Statutory Criteria

Question 1 (A).....I am concerned that the Post Exceptions Proposed Order's (PEPO) findings on several statutory criteria do not consider all relevant factors.

Specifically, the PEPO finds that the Alternative Regulation (Alt Reg) Plan encouraged innovation in telecommunications services, despite Ameritech providing only one example of an innovative new service for the record (i.e., Privacy Manager).[1]
Also, the PEPO finds that the Alt Reg Plan facilitated the broad dissemination of technical improvements and enhanced economic development, despite the service quality problems experienced in Illinois and Ameritech's decision to suspend network upgrades. Moreover, the PEPO's conclusions on these criteria do not address any arguments that were raised to the contrary.

Assuming that a majority of the Commission agrees that the current plan does not satisfy these statutory criteria, what solutions could be instituted to resolve these shortcomings and ensure that Ameritech's Alt Reg Plan, on a going-forward basis, complies with the law?

Question 1 (B)... Section III (7) of the PEPO states, "[T]he Commission further observes that economic development depends on the availability of telecommunications service of sufficient quality and quantity offered by a variety of carriers. As such we cannot disregard the investments AI made in opening its network to competitors. On the whole and in these premises, the statutory requirements have been fulfilled."

> i) The above excerpt states that economic development depends on telecommunications services of sufficient quality, and the Alt Reg Plan satisfied the statutory criteria of enhancing economic development. However, the PEPO finds, in later sections, that the Alt Reg Plan failed to maintain service quality (thereby suggesting that telecommunications services were not of sufficient quality). Could you reconcile these two portions of the PEPO?
>
> ii) In finding that the Alt Reg Plan satisfies this statutory criterion, the PEPO gives considerable weight to the "investments AI made in opening its network to competitors". Was evidence provided questioning AI's compliance with market opening requirements? Examples could include, but are not limited to, 1) wholesale performance penalty payments; 2) litigation in Docket Nos. 96-0486, 98-0396, 99-0593, 99-0615, etc; 3) number of bankrupt CLECs; 4) Ameritech's decision to halt its network upgrade dubbed Project Pronto. If so, what weight, if any, did you give to this evidence in your finding that the Alt Reg Plan satisfied this statutory criterion?

[1] I do not believe that re-packaging currently available services is "innovation in services" as Section 13-506.1(a) requires.

RESPONSE *to Question* 1 (A) *and* (B):

I. The Elements of Section 13-506.1 (b)(4).

Section 13-506.1, like any other statute, requires a close and careful reading of its provisions in order to effect the legislature's intent. On the whole, Section 13-506.1(b) conditions the Commission's approval of an alternative regulation plan on a set of seven minimum findings. Among those, and pursuant to subsection (b)(4), the Commission's approval requires a finding that, the plan or modified plan:

> ...(4) constitutes a more appropriate form of regulation based on the Commission's *overall consideration* of the policy goals set forth in Section 13-103 and this Section. 220 ILCS 5/13-506.1 (b)(4). (Also referred to as Finding No. 4 in this memo).

The policy goals referred to above, are those set out in subsection (a) of Section 13-506.1, where in determining the appropriateness of any alternative "form" of regulation, for a company providing noncompetitive services, the Commission is *required to consider* whether such form will:

> (1) reduce regulatory delay and costs over time;
> (2) encourage innovation in services;
> (3) promote efficiency;
> (4) facilitate the broad dissemination of technical improvements to all classes of (noncompetitive services) ratepayers;
> (5) enhance economic development of the State; and
> (6) provide for fair, just, and reasonable rates.

The policy provisions stated in Section 13-103 closely, but not completely, track the above stated considerations.

Pursuant to Section 13-103, the General Assembly declares it to be the policy of the State of Illinois that:

> (a) telecommunications services should be available to all Illinois citizens at just, reasonable, and affordable rates and that such services should be provided as widely and economically as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest; (Emphasis added).

Note: This goal lends itself to subsection (a) (6) above.

> (b) consistent with the protection of consumers of telecommunications services and the furtherance of other

> public interest goals, competition in all telecommunications service markets should be pursued as a substitute for regulation in determining the variety, quality and price of telecommunications services and that the economic burdens of regulation should be reduced to the extent possible consistent with the furtherance of market competition and protection of the public interest; (Emphasis added).

Note: This goal is reflected in subsection (a)(1) above.

> (c) all necessary and appropriate modifications to State regulation of telecommunications carriers and services should be implemented without unnecessary disruption to the telecommunications infrastructure system or to consumers of telecommunications services and that it is necessary and appropriate to establish rules to encourage and ensure orderly transitions in the development of markets for all telecommunications services; (Emphasis added).

Note: This was not an issue in 1994; it remains a non-issue here.

> (d) the consumers of telecommunications services and facilities provided by persons or companies subject to regulation pursuant to this Act and Article should be required to pay only reasonable and non-discriminatory rates or charges and that in no case should rates or charges for non-competitive telecommunications services include any portion of the cost of providing competitive telecommunications services, as defined in Section 13-209 [220 ILCS 5/13-209], or the cost of any nonregulated activities; (Emphasis added).

Note: This goal also embraces aspects of subsection (a) (6) above.

> (e) the regulatory policies and procedures provided in this Article are established in recognition of the changing nature of the telecommunications industry and therefore should be subject to systematic legislative review to ensure that the public benefits intended to result from such policies and procedures are fully realized; (Emphasis added).

Note: The General Assembly did in fact review Article XIII and amended several parts thereof in July 2001. Its actions, which set policy into law, must be considered.

> (f) development of and prudent investment in advanced telecommunications services and networks that foster economic development of the State should be encouraged

> through the implementation and enforcement of policies that promote effective and sustained competition in all telecommunications service markets. (Emphasis added).

Note: This goal is reflected in subsection (a)(5) above.

(All of these policy matters apply to the whole of Article XIII, as amended, and not to Section 13.506.1 exclusively).

II. Commission Interpretation of Section 13-506.1 (b)(4).

In the Alt Reg order, the Commission rejected the view that it needs to find that each and every one of the policy goals set out in Section 13-103 and the considerations set out in Section 13-505.1 (a) will be promoted, or will actually occur, if the plan is adopted. (Alt Reg Order at 180). The Commission interpreted Finding No. 4 to mean that it must consider the policy goals set forth in Sections 13-103 and 13-506.1 (a), and," based on the Commission's overall consideration," determine if the plan constitutes a more appropriate form of regulation." (Id.) If it makes this determination, the Commission reasoned, it has made the finding required under subsection (b) (4) of the relevant statute. (Id.) See 220 ILCS 5/13-506.1 (b)(4).

III. The Pertinent Question On Review.

The language of Section 13-506.1 (b) (4) clearly calls for a comparison to be made based on an "overall" consideration of the elements, i.e., the goals referred to therein.

In a review proceeding, such as this, the question is whether, based on its "overall consideration" of these goals, and the evidence thereon, a return to rate-of return regulation is warranted. Or, stated another way, whether the plan more appropriately addresses the overall goals in the statute, equal to or better than would traditional regulation.

CUB understands this proposition very well. Whether addressing the policy goals of regulatory costs and delay (a)(1); or economic development (a)(5); or the facilitation of technical improvements to all classes of ratepayers (a)(4); or innovation (a)(2); CUB consistently maintains that nothing resulting from the plan exceeds what traditional regulation would have provided. According to the AG, alternative regulation must surpass traditional regulation in its ability to promote the goals of Section 13-103 and produce just and reasonable rates.

In response to Commissioner Squires' insightful questions, we looked more closely at the PEPO. In doing so, we came to realize that the PEPO needs to be, and should be, structured in a better fashion so as to apprise the Commission of the determination it need ultimately make on this review.

Indeed, guided by the parties' briefs, the PEPO separates out the various elements of Section 13-506.1(b)(4) in a manner that may confuse the Commission. These elements are considerations and policy goals and not independent statutory criteria per se. Cumulatively, and not individually, they comprise matters for the Commission's overall consideration in determining the appropriateness of alternative regulation. Further, although not addressed in the parties' briefs or in the PEPO, there is the need to consider the recent legislative changes for the analysis at hand. The "goal" set out in Section 13-103 (e) so directs.

To correct these drafting errors, and assist the Commission with respect to the "overall" finding in accord with its review under the statute, i.e., Section 13-506.1 (b)(4), we recommend the following:

Items 2, 3, 7, and 8, under Part III of the PEPO, all of which fall within the criteria of Section 13-506.1 (b)(4), and all of which the Commission is to give "overall" consideration to, should be treated jointly as per the statute. Hence, each of these sections should be stricken and replaced with the New Proposed Language for the Order that we attach hereto. (See Attachment A to this Response, which also includes a revision to the Table of Contents for Part III of the PEPO). We also believe that this "new" language fully and directly responds to the questions at hand.

Note: The Commission should not lose sight of the fact that the Plan at issue is a retail plan governing noncompetitive services. All of the provisions of Section 13-506.1, including subsection (b)(4) in all its elements, must be viewed and considered in light of the statute's carefully prescribed purposes.

2. Service Quality ("Q"):

Question 2 (A).... Would you agree that when compared to the current price cap formula, the PEPO's recommendation to remove Q from the price cap formula, all else equal, would provide more pricing flexibility to Ameritech in all baskets in times of service quality degradation?

RESPONSE to Question 2 (A):

As we understand it, removing Q from the price cap formula lessens the downward pressure on all rates (in the event of missed benchmarks).

The Q affects the PCI (which sets the upper limit for rates).
Every basket has an API, which cannot be higher than the PCI.

If the Q gets larger, the PCI gets smaller.
A lower PCI means that the individual APIs will be lower.
Thus, there is less room for variation in the baskets.

Conversely;

If the Q is small, or at 0, the PCI is larger.
A higher PCI means that the individual APIs can also go higher.
Thus, there is more room for pricing variation in the baskets.

Question 2 (B)..... If the Commission chose to leave the service quality factor (Q) in the Price Cap formula (which the PEPO removes), but also wanted to increase the penalties for service quality violations (as the PEPO proposes), which party's penalties proposal would you recommend?

RESPONSE to Question 2 (B):

AI was the only party to directly support this option (with one proposed change to the status quo).

Both Staff and the GCI, however, did include proposals for the Commission to consider if it desired to keep the Q component in the formula. Each of these proposals would serve to increase current penalties.

Ameritech Illinois:

Currently, AI contends, if the Company misses a benchmark, a permanent 0.25 % reduction of the PCI is required even if it never misses that benchmark again. To correct this imbalance, AI proposes that the PCI be adjusted back upwards when the Company subsequently achieves a benchmark that it previously missed. (AI raises a valid point).

Staff:

Staff proposes that all of the measures, with the exception of the OOS > 24 hrs and Installation standards, be given an equal weighting of 0.25 %. With respect to OOS> 24 hrs and the Installation measures, Staff recommends an increase to 2%.

According to Staff's proposal, the Company would receive a score of 0 for each benchmark met. Staff also recommends a return to 0, if the Company subsequently meets the failed benchmark for 12 consecutive months. (Staff essentially recognizes the merit to AI's proposal).

Staff includes an additional proposal such that – if the Company's performance falls below 5% of a benchmark, it would need to reduce rates by 2%. For each additional 5% decline in performance, rates would be decreased by another 1.5 %.

The GCI/City:

The GCI propose increasing the current 0.25 % adjustment to 1.25% overall. These parties acknowledge, however, that their proposal relative to the Q component, would bring about penalties slightly higher than the $12 million per violation that they recommended as an adjustment outside the PCI. Further, they suggest escalations for severity and repeated or multiple violations per the formula and calculation as appears in GCI/City Ex. 2.0 at 74-75)

ALJ Views:

None of the parties revisited any of these early proposals, relative to Q, subsequent to the passage of the new law, enacted in July 2001. It is important for the Commission to consider, however, that leaving the Q factor in the price cap formula, does not excuse AI from the customer compensation provisions of Section 13-712 and its emergency Part 732 rules based thereon. The result thereof being that affected customers will be credited under Section 13-712 and all customers, including those affected, will see reduced rates through the Q. Presumably all of this compensation would be available for offset to any other fines.

On the whole, Staff's proposals appear to be easily understandable and more fairly directed to meeting the Commission's objective of having the Company maintain service quality. We agree, in particular, with Staff's recommendation of having the Company returned to 0 status when and if it subsequently meets a failed benchmark. This feature is critical to performance success by keeping the incentive viable.

Note: While the Commission can only require service to be "maintained" at a certain level, i.e., historical benchmark or as set by rule (indeed, the whole point behind Section 13-506.1, is to not have the company lessen its service quality just because of the change in form of regulation), it can further incent the Company to excel.

If the Commission is seriously interested in "improving", and not merely "maintaining" service quality, it might consider providing an additional incentive to the company for exceeding the performance benchmarks it establishes. This action was previously recommended, but not authorized.

In the original Alt Reg Order proceeding, Illinois Bell proposed that the price index formula include a service quality component "that would result in an upward adjustment if the Company improve[d] service and would result in a downward adjustment if service deteriorate[d]." (Alt Reg Order at 56). The Commission, however, agreed with the positions of the AG, Staff, and MCI by adopting a service quality component that simply penalizes the Company for not maintaining service quality but provides no reward for exceeding current performance standards.(Id.)

Common sense tells us that a "carrot and a stick" approach, is more meaningful than a stick alone. It inspires a positive and uplifting attitude at all levels of the Company. Realistically, it is the company's employees that are put on the street to address consumer complaints and it is the individual worker in the field, as well as the "Company" who must be incented to perform to standard. Whereas, we would assume that penalties are not visited upon employees, rewards for performance could, conceivably, be shared.

This type of additional incentive only appears to be available with the use of the Q component. We considered, but were unable to arrive at a means by which to incent higher performance levels with the penalty structure being put outside the index as the Staff and GCI/City had recommended.

Question 2 (C)... Which party suggested the $8 million penalty for sub-standard service quality proposed in the PEPO?

RESPONSE to Question 2 (C):

No party proposed this exact amount. It was derived on the basis of reasoned judgment based on relevant facts and circumstances. We considered a doubling of the previous approximate penalty amount, i.e., $4 million, to be appropriate in sending the right message to the Company without overly and unrealistically compensating customers.

As best as we can recall, the only party that strongly excepted to the $ 8 million penalty amount, was Ameritech (based on contentions that most of its service quality performance, with certain notable exceptions, was up to standard).

Question 2 (D).... It is my understanding that under the current Alt Reg Plan, the absolute value for the Q factor is 0.25 per violation, which results in an approximate reduction in rates of $4 million.

If the Commission were to support the concept of the $8 million penalty per violation and also retention of the Q factor, could it simply raise the 0.25 Q factor to 0.5 (0.25 x 2) to arrive at the desired penalty amount, i.e., $8 million ($4 million x 2)?

If not, please describe if and how the Commission can arrive at the proposed $8 million penalty amount and retain the Q factor.

RESPONSE to Question 2 (D):

If the 0.25 Q factor = $4 million, then doubling the factor to 0.5 should = $8 million.

It should be noted, however, that the actual dollar amount of Q is a direct result of revenues subject to the Alt Reg Plan. If services drop out of the Alt Reg Plan (such as the recent reclassification of business services), or, if customers switch to other carriers, revenues will decrease and so would the reduction in rates as a result of Q.

Or, put another way:

If revenues increase, the amount that is Q also increases.

If revenues decrease, the Q is also a lesser amount.

Thus, it may be impossible to lock in a firm and absolute $8 million penalty for all time. The value remains an approximation.

3. Subjecting UNEs to the Price Cap:

Question 3 (A)...I have reviewed the reasoning in the PEPO for adding UNEs to the Alt Reg Plan and I am not convinced all of the relevant issues were addressed. Please explain whether a discussion of any the following issues were included in the record evidence and/or factored into your decision to add UNEs:

RESPONSE to Question 3...generally.

Arguments of Ameritech, Staff, City/Cub and AT&T were considered when reaching the conclusions found in the PEPO.

Question 3 (A)(i)... the appropriateness of subjecting UNEs, which are required to be priced according to federally-mandated Total Element Long-Run Incremental Cost (TELRIC) principles, to non-cost-based factors such as exogenous factors and retail service quality problems;

RESPONSE to Question 3 (A)(i)

A discussion as to the appropriateness of subjecting UNEs to the PCI formula can be found within the PEPO. With respect to the appropriateness of subjecting UNEs to non-cost-based factors such as exogenous factors and retail service quality problems I would point out that there has been just one occasion where the Commission has permitted exogenous treatment since the Alternative Regulation Plan became effective. With respect to retail service quality problems, under the PEPO, the Q factor has been removed from the PCI formula and therefore there would be no direct relationship between UNE's and service quality. The PCI formula is intended to replicate a competitive market where one does not exist. Application of UNEs, where there are no real competitive providers, to the formula is appropriate.

Question 3 (A)(ii)... the possibility of increasing the price of UNEs through rate reductions for other services in the Carrier Basket;

RESPONSE to Question 3 (A)(ii)

A possibility of increasing the price of UNEs through rate reductions for other services in the Carrier Basket exists. However, such an increase would require a like decrease of other services within the Carrier Basket.

Question 3 (A)(iii)... carriers that rely on Ameritech's UNEs for provisioning of telecommunications service may not have had the notice and/or opportunity to intervene in this docket to provide evidence on the issue;

RESPONSE to Question 3 (A)(iii)

A printing of the service list from E-Docket for Docket 00-0764 resulted in a ten page listing of those persons/entities that are sent notices. Included within the service list is: AT&T, McLeod USA, Covad, NEXTLINK, Focal, Verizon, MGC Communications, Z-Tel, and Sprint to name a few. The Chief Clerk may be in possession of a more complete service list for Dockets 98-0252 and 98-0335. If however you are asking whether there could be a CLEC who purchases UNEs from Ameritech who has not intervened, the answer would be yes that possibility may exist. A review of the service list indicates the several significant market participants have had notice and have participated in the proceeding.

Question 3 (A)(iv)... administrative burdens to both Ameritech and the Commission related to re-calculating UNE prices (including shared and common costs) and filing new UNE tariffs on an annual basis;

RESPONSE to Question 3 (A)(iv)

In briefs, no party complained of potential burdens to either Ameritech or to the Commission. With respect to Ameritech, the "burden" would be the filing of an updated tariff to include the corrected price of the UNEs based upon application of the PCI. As for a "burden" to the Commission, I would expect that it would have to accept the Company's annual tariff filing.

Question 3 (A)(v)... regulatory uncertainty in Illinois faced by competitive local exchange carriers due to annually-changing (and possibly increasing) TELRIC rates.

RESPONSE to Question 3 (A)(v)

One of the parties who championed the position to include UNEs within the PCI formula is a CLEC. There exists the real possibility that UNE prices may fall or rise, depending upon the PCI. However, if the CLEC who made the proposal were truly concerned about uncertainty it is doubtful they would have propounded such a position.

4. Clarification of Exogenous Change Factor (Z):

Question 4 .....Does either the Public Utilities Act or the original Alt Reg Order prohibit Ameritech from requesting from the Commission exogenous treatment for a

Commission-mandated rate reduction under the Z factor, assuming the rate reduction satisfies the established Z criteria?[2]

RESPONSE to Question 4

Neither the Public Utilities Act nor the Commission's Order in the original Alternative Regulation docket bar Ameritech from requesting exogenous treatment for a Commission-mandated rate reduction under the Z factor. Nor do they require that Ameritech be given relief for all exogenous events. The Z factor was a Commission created element of the PCI formula. It was intended as an equitable tool given that the formula is an over simplification of a complex public policy. The PEPO does not bar the Company from requesting exogenous treatment resulting from Commission-mandated action but rather permits the Company the ability to request such treatment. The Company still must satisfy the four criteria as set forth in the original Alternative Regulation Order. Particularly, the Company must show that the costs it seeks exogenous treatment for were actually outside the Company's control.

5. Phase-In of New Benchmarks:

Question 5..... Did the Commission allow Ameritech to phase-in the benchmarks established for the service quality component (Q) in the original Alt Reg Order?

RESPONSE to Question 5:

No "phase-in" of benchmarks appears to have been proposed by any party in the Alt Reg proceeding. Thus, the Commission was not asked for such relief and did not, solely on its own initiative, take such action. We note, however, that with respect to the 8 measures and benchmarks established in 1994, 7 of these 8 measures were pre-existing standards, i.e., part of the Commission's service monitoring and reporting rules. (Alt Reg Order at 56).

In this proceeding, there are several "new" measures and associated benchmarks being suggested and, it is only with respect to these new standards that a phase-in was recommended. The PEPO adopts Staff's particular proposal.

It is reasonable to expect that any company being subjected to new standards needs time to train its employees; determine the need for new hires or transfers; outline, implement, and test effective performance-raising strategies; set up recording processes, etc. Only a final order triggers decisive action in these respects.

6. Adopting Part 732 Exemptions:

Question 6 (A)..... The PEPO imports the service quality exemptions adopted in Part 732 into the Alt Reg Plan. Did any party address this issue in testimony?

[2] [1. outside company control, 2. not reflected in economy-wide inflation factor, 3. verifiable/quantifiable, and 4. +/-$3 million].

RESPONSE to Question 6 (A):

(Re: the PEPO at 198)

The exceptions, in question, appear in the new law, i.e., Section 13-712(a) (6), which went into effect in July, 2001.

The record was not reopened for additional testimony after the legislative changes were enacted. Instead, the parties addressed the relevant new provisions and statutory modifications in a round of arguments on briefs. In its brief, AI proposed the inclusion of the exceptions. No party or Staff objected.

We took account of the new law, as required, when drafting the PEPO. In doing so, we considered all relevant statutory changes, including the exceptions in Section 13-712. We further noted that the Commission included the subject exceptions in its emergency rules.

Question 6 (B)...... It is my understanding that no one addressed this issue in testimony in Docket No. 01-0485 (Code Part 732 case) where the exemptions were initially established. Is that correct?

RESPONSE to Question 6 (B):

(Re: PEPO at 198).

The exceptions in question were initially established in newly enacted Section 13-712 (a) (6), which went into effect on July, 2001. In Docket 01-0485, the Commission adopted emergency rules to implement Section 13-712 and included therein these exceptions. The Commission took such action just prior to the time that the PEPO was drafted.

The record in this proceeding does not indicate, and we take no account of, what subsequently might have transpired in the 01-0485 proceeding (with respect to the testimony filed or not filed). As a general matter, testimony in other dockets is simply not relevant. In select instances, however, final orders, that include parties' testimonial accounts, may be relevant or material to an issue. We do not believe that a final order has issued in Docket 01-0485, since it is a complex rulemaking matter.

This said, the proposition set out in Question 6 (B) seems to be correct. In Docket No. 01-0458, the only apparent issue regarding the exemptions listed at § 732.30(e) deals with a carrier's reporting obligations where customer credits are denied because of a listed exemption. The Government and Consumer Interveners (GCI) argue that § 732.30(e) should include a requirement "that customers who are denied credits because of a claimed exclusion based on customer conduct be informed of the reason for such denial." (GCI Brief on Exceptions at 9). Without a final order, either rejecting or adopting this proposal, we cannot take account of this testimony (it is not testimony on record for this case) or in any way interfere with this separate pending proceeding.

If it so chooses, however, the Commission can, certainly clarify that the exceptions here incorporated are subject to any requirements related thereto as will ultimately be established by rule in pending Docket 01-0485.

Question 6 (C).... What service quality exemptions, if any, were approved in the original Alt Reg Order?

RESPONSE to Question 6 (C):

None, as far as we can tell in reading the Alt Reg Order. Of course, Section 13-712 was not in effect back in 1994. (There were, however, some exemptions from service standards set out in Sections 730.535 and 730.540 of the Commission's rules, i.e., 83 Ill. Adm. Code 730). The exemptions are now part of the law and must be considered. These exemptions indicate that the General Assembly did not intend to impose customer credit liability with respect to carrier performance, without taking account of any mitigating circumstances. Moreover, the circumstances outlined in Section 13-712 (e)(6) appear wholly reasonable.

220 ILCS 5/13-712(e)(6) reads as follows:

(6) Credits required by this subsection do not apply if the violation of a service quality standard:

(i) occurs as a result of a negligent or willful act on the part of the customer;

(ii) occurs as a result of a malfunction of customer-owned telephone equipment or inside wiring;

(iii) occurs as a result of, or is extended by, an emergency situation as defined in Commission rules;

(iv) is extended by the carrier's inability to gain access to the customer's premises due to the customer missing an appointment, provided that the violation is not further extended by the carrier;

(v) occurs as a result of a customer request to change the scheduled appointment, provided that the violation is not further extended by the carrier;

(vi) occurs as a result of a carrier's right to refuse service to a customer as provided in Commission rules; or

(vii) occurs as a result of a lack of facilities where a customer requests service at a geographically remote location, a customer requests service in a geographic area where the carrier is not currently offering service, or there are insufficient facilities to meet the customer's request for service, subject to a carrier's obligation for reasonable facilities planning.

7. Installation Benchmark

Question 7..... It appears that the PEPO reduces the Installation benchmark from 95.44% to 90% because the definition of "installation" was clarified to exclude vertical services.

Was the 90% benchmark derived from Ameritech's historical data?

If not, how can the Commission ensure that lowering the benchmark from 95.44% to 90% will "maintain" service quality as the law requires?

RESPONSE to Question 7:

(Re: PEPO at 160-161).

It is essential to understand that the PEPO is not reducing or lowering the benchmark in this instance. It is simply starting over with a performance measure that, for the first time, is clearly defined as excluding the installation of vertical services.

The PEPO is recognizing that the way this measure has been considered over all the prior years, is simply wrong for present purposes. In other words, both the installation measure and benchmark has always, up to now, included vertical services installation. On this point, we agree with Staff and the GCI that this situation needs to be corrected. That said, we did not agree that a measure can be defined anew (to exclude matters previously included) without also reexamining the propriety of the old benchmark. This type of proposition defies logic and integrity.

To illustrate this concept:

Y-1 corresponds to Y
(old benchmark) (ill-defined measure)

Y-1 does not correspond to X
(old benchmark) (new definitive measure)

X-1 must correspond to X
(new benchmark) (new definitive measure)

When clarifying/changing the definition of a measure, it is necessary to set an appropriate benchmark that corresponds to the newly-defined performance standard. Generally, this has required a look at historical performance data.

To be sure, the Alt Reg Order adopted eight, separate quality of service measures using the Company's average actual performance in 1990 and 1991 as performance benchmarks. Since the Company's performance at that time exceeded the Commission's Part 730 rules, which are intended to be minimum standards that all LEC's must satisfy, the Commission viewed it is necessary to establish these "higher" standards to safeguard against erosion of service quality. (Alt Reg Order at 58).

In this instance, only limited data is available for installation orders that exclude vertical services, and this data shows that AI would not have, on a consistent basis, achieved the 90% standard set in the Commission's Part 730 rules. In other words, there is no available data for the measure, as the Commission is now defining it, showing the Company to have exceeded Part 730 standards.

This essentially means that AI was not maintaining service historically at the 90% level under the new definition. We would be "reducing" service quality only if we took this history into account and set the benchmark below 90%. This, however, the PEPO does not do.

It recognizes that in instances where the Company's performance historically has not proved reasonable (with reasonableness being itself defined as in keeping, at the least, with Part 730 rules), the standards of Part 730 should settle the benchmark. There is precedent for such action (See, for example, the OOS>24 hrs situation) and is wholly appropriate for present purposes.

ATTACHMENT "A"

(Old Outline for Part III of the PEPO)

(New Outline for Part III of the PEPO)

III. THE STATUTORY CRITERIA AND GOALS

A Has the Plan Produced Fair, Just, and Reasonable Rates.
(Section 13-506.1 (b) (2)).

B Did the Plan Respond to Changes In Technology And The Structure Of The Telecommunications Industry That Are, In Fact Occurring.
(Section 13-506.1 (b)(3)).

C. Does the Plan Constitute a More Appropriate Form Of Regulation, Based On An Overall Consideration of Both Section 13- 506.1(a) and the Section 13-103 Policy Goals.
(Section 13-506.1 (b) (4)).

D. Has the Plan Produced Efficiency Gains and Cost Savings
Section 13-506.1 (b)(5)).

E. Has the Plan Served to Prejudice Or Disadvantage To Customer
(Section 13-506.1 (b)(7)).

F. Has the Plan maintained the Quality and Availability of Telecommunications Services.
(Section 13-506.1 (b)(6)).

G. Is the Plan in the Public Interest
(Section 13-506.1 (b) (1)).

[New Section C.]

C. Does the Plan Continue to Constitute A More Appropriate Form Of Regulation Based On The Commission's Overall Consideration of Section 13-506.1 (a), and the Section 13-103 Policy Goals.

By far, the most complex finding (in terms of form) that the Commission was required to make when approving the Plan, is set out in Section 13-506.1 (b) (4). This ostensibly short directive required us to consider the six items listed under Section 13-

506.1 (a)(1-6), as well as another six policy statements or goals, as set out in Section 13-103 (a-f). We followed through on this detailed task, as is shown at pages 180-186 of the 1994 Alt Reg order, and ultimately determined in favor of alternative regulation for AI.

Here we reexamine those earlier pronouncements together with the current showings and positions of the parties in this review proceeding. To be sure, there is considerable overlap with respect to these many goals, and the parties to this proceeding have only put a select few into issue.

At the outset, we will re-state the premise that guided our initial review of each of these elements, outline the parties positions and revisit our original observations and expectations. In the very end, we will determine whether our "overall" consideration of these matters leads to a conclusion that the Plan remains a more appropriate form of regulation than traditional rate-of return regulation.

<u>Premise No. 1</u> – The Alternative Form of Regulation Reduces Regulatory Delay and Casts Over Time.

Authority: Section 13-506.1 (a) (1)); Section 13-103 (b); Alt Reg Order at 180-181.

The Alt Reg Order

In our 1994 Order, the Commission recognized that traditional rate of return regulation imposed significant costs on all parties involved, with exhaustive 11-month proceedings. The Commission found that price regulation, in contrast, would permit streamlined proceedings and would eliminate regulatory review of the "prudence of incurred costs, equipment replacement and cost of capital". (Alt Reg Order at 180-81).

AI's Position

AI takes the position that the Plan clearly met the requirements of the law and the Commission's expectations. According to the Company, the annual filing process has worked well. It has been very streamlined and rate changes go into effect in three months, and not the customary 11 months.

It makes no sense, AI contends, to count against the Plan the 22 months which it took the Commission to adopt it in the first place given that this was a major and unexplored regulatory change warranting serious review. In AI's view, none of the usual active participants in telecommunications dockets (the Company, Staff or the Intervenors) could possibly have devoted more resources to the price cap filings than they would have to one or more general rate cases during this period.

While CUB complains that the cumulative amount of time required by the annual filings exceeds that of a general rate case, such a contention is, according to AI, patently untrue. CUB further claims that the SBC/Ameritech merger and competitive, classification proceedings would not have occurred under rate of return regulation. According to AI, however, SBC made clear in the merger proceeding that the driving force behind the merger was the need to achieve the scale and scope of a global telecommunications company and thus, only financially punitive regulatory climates in all five Ameritech states (not just continued rate of return regulation in Illinois) would likely have changed SBC's decision. AI further contends that competitive classifications actions have nothing to do with the Plan. It states that these reclassifications could and would have been made regardless of what form of regulation applied.

Staff's Position

According to Staff, here is little doubt but that the Plan has resulted in reduced regulatory delay and costs. This is especially so, Staff maintains, given that rate reductions thereunder have been automatic. (Staff Initial Brief at 32)

CUB's Position

CUB contends that, as GCI witness Dr. Selwyn observed, the Plan has not met the objective of Section 13-506.1(a). To begin, CUB notes that the Alt Reg. proceeding took 22 months to complete. In addition, CUB notes that a 3-month proceeding occurs each year whereby noncompetitive rates are set. To this, CUB would add both the time expended on the SBC/Ameritech merger proceeding and the proceeding to challenge premature classification of services from noncompetitive to competitive. These proceedings, CUB argues, only occurred because AI was under price cap regulation and may well have been avoided had the Company remained under rate of return regulation. When considered cumulatively, CUB argues, these proceedings significantly surpass the amount of time that would be spent on three, 11-month rate cases and show that the AI price cap plan has *not* reduced regulatory delay and costs over time.

Commission Review of Premise No. 1

Our original premise remains valid to date. CUB's position on this item is simply not credible. The standard is the reduction of delay and costs "over time" and, as such, does not count the 22 months spent at the outset to establish a plan. We are not persuaded that either the merger or reclassification proceedings are viable considerations. Moreover, the measure includes not only time, but the breath and depth of the work involved. The annual filings here produce an outcome for each year of the Plan without the intensity and effort required in rate cases. It is thus only reasonable to conclude that the Plan has satisfied this goal.

Premise No. 2 - The Alternative Form of Regulation Encourages Innovation in Telecommunications Services.

Authority: Section 13-506.1(a)(2) and Alt Reg. Order at 181.

The Alt Reg Order

In 1994, the Commission expected that the prospects of higher earnings would incent the Company to aggressively develop and offer new services; that the removal of prudency reviews would encourage the Company to be more innovative and take more risks; and that the ability to change its prices without regulatory involvement would allow the Company to experiment more in the marketplace. (Alt Reg Order at 181.)

AI's Position

Ameritech Illinois contends that it has been more innovative with new services being an important factor in generating revenue growth. AI provides, as an example, its offering of "Privacy Manager" which allows customers to pre-screen their calls and eliminate telemarketing or other unwanted intrusions. Ameritech points out that it was the first RBOC in the nation to offer this service, which is now widely imitated. The Company also claims to have experimented in the marketplace with a large number of promotional offerings and the introduction of optional calling plans. Today, AI contends, a substantial portion of its residential customers, take service under one of these plans.

In response to Dr. Selwyn's apparent belief that the Company's usage rate structure should be less distance-sensitive, AI points out that this is a rate design judgment call, not a matter of "innovation". So too, AI notes, Dr. Selwyn's claim that Ameritech Illinois's roll-out of DSL has been too slow ignores the fact that this service is offered by Ameritech Illinois' affiliate AADS. The Company argues that, as in other instances, AADS' deployment record cannot be counted against Ameritech Illinois.

The complaint that most "innovations" can be traced to equipment vendors, and not Ameritech Illinois, does not make it a Company failing, AI maintains. Indeed, the point that vendors develop the switch hardware and software which enables new features and functionalities for the entire industry, was first set out in AI's own testimony. (See, Am. Ill. Ex. 1.1, p. 51). There, Mr. Gebhardt explained that the development of truly "new" services depends on the capabilities of the switching fabric itself, which has been the province of switch vendors. Short of becoming an equipment manufacturer, hardly a realistic alternative, AI maintains that its service introduction record is solid.

CUB's Position

CUB suggests that no more innovation occurred under the Plan than would have otherwise under rate of return regulation. As pointed out by City witness Dr. Selwyn, CUB maintains that basic telephone service in Illinois today is hardly different than that which existed in 1994. According to CUB, whatever "enhancements" or "innovations" in services have taken place are traceable primarily to equipment vendors rather than to specific AI initiatives.

CUB further contends that despite the fact that the costs of individual telephone calls are virtually distance-insensitive, and the costs of network usage have declined dramatically over the past decade, AI continues to make unwarranted distinctions in name and price in local and toll calls. In addition, CUB claims, AI has actually increased its rates for certain local and intralata calls. Further, CUB notes that although DSL technology has been around for a number of years, it is available in only a limited number of exchanges, and to only a limited number of subscribers within those exchanges to only a limited number of subscribers. CUB also notes that AI has chosen to suspend its "Project Pronto" deployment of DSL service. According to CUB, the Plan has *not* encouraged innovation in telecommunications services.

Commission Review of Premise No. 2

As a practical matter, innovation is the life-blood of any company and one feature it would not intentionally neglect. While the innovations that Ameritech describes are limited, there is nothing relevant on record to suggest that the Plan itself failed to "encourage" innovation.

As AI points out, and Cub itself acknowledges, most innovations in service are driven by vendor initiatives. The AI offerings with respect to new types of calling plans, which CUB minimizes, take on added significance in light of recent legislative activity. We are compelled to note that in amending the Act, the General Assembly required that certain types of service plans be offered, to the average customer, by those carriers operating under alternative regulation. See Section 13-518. It has, by such action, set out the policy goals of innovation into law. As such, we still accept the premise, overall, that the plan encourages innovation as good, or better, than does traditional regulation.

Premise No. 3 - The Alternative Form Of Regulation Promotes Efficiency.

Authority: Section 13-506.1 (a) (2); Alt Reg Order at 181.

The Alt Reg Order

In 1994, the Commission noted that, under traditional regulation (which utilizes primarily a cost-plus approach to ratesetting), any efficiencies implemented by the company would be reflected as a reduction in the cost of service and rates in the next rate case. The Commission observed that where only short-term benefits can be realized through efficiencies, there is limited incentive to implement same. On the other hand, alternative regulation was expected to encourage the Company to operate efficiently because it puts AI at risk for how well or how poorly it operates and contains costs.

AI's Position

AI maintains that the Plan did provide new incentive to spur efficiencies. According to its witness, Mr. Gebhardt, the Company has focused on customer-oriented marketing strategies and streamlined its decision-making, thereby becoming more responsive and more efficient.

CUB's Position

The alleged improvements in the Company's management structure, CUB claims, have not benefited residential customers. More specifically, CUB argues that service quality declined when considered in terms of the restoration of service outages, installation of access lines, and the keeping of customer premises visit appointments. CUB suggests that the Company confused a failure to invest in POTS-related technology and its workforce with increased "efficiency."

Commission Review of Premise No. 3.

We remain convinced of the merit to our original premise. In our view, the Plan has, and continues to offer the right incentive for promoting efficiencies within the Company. There is no viable assertion or evidence to the contrary.

Whether such efficiencies impacted adversely on service quality is a question to be explored in another part of this Order. See, Part III, Section D, below. So too, the benefits to customers from such efficiencies are being addressed more directly in our review of the Section 13-506.1 (b) (6) finding. See Part III, Section F. At this moment, however, we consider and conclude that the plan overall remains a better form of regulation to promote efficiency.

Premise No. 4 – The Alternative Form of Regulation Facilitates The Broad Dissemination of Technical Improvements To All Classes of Ratepayers.

Authority: Section 13-506.1 (a) (4); the Alt Reg Order at 182.

The Alt Reg Order

In its 1994 Order, the Commission concluded that price regulation provided the appropriate incentives to encourage market-based investment in infrastructure; that the Company had made a $3 billion commitment to grow and modernize its network; and that, because most of Ameritech Illinois' plant-in-service is used to provide service jointly to all customer classes, "all classes" of customers would benefit from this investment. (Alt Reg Order at 182, 183).

AI's Position

Ameritech Illinois contends that it not only met, but also, exceeded its $3 billion commitment by spending $3.7 billion. Those investments, AI contends, facilitated the development of an advanced telecommunications infrastructure. Today, AI maintains all of Ameritech Illinois' customers have digital switching capabilities available to them. So too, virtually all of the Company's interoffice facilities are now fiber. Further, over 90% of the Company's access lines have access to ISDN. In addition, SS7 deployment is complete and 65% of the Company's central offices have been equipped with the AIN platform. All of these technologies, AI claims, are important building blocks for advanced services.

With respect to Ms. TerKeurst contentions that AI's service quality problems demonstrate that it invested in high margin services/customers at the expense of basic service customers, the Company notes that there is no evidence whatsoever to support such a claim. In fact, AI contends, because the Company's network primarily consists of common plant, it is virtually impossible for to do as Ms. TerKeurst suggests. And if any customer group benefited disproportionately from Ameritech Illinois' network investments, AI argues, it is the CLECs -- who are most definitely not the Company's "high margin services/customers".

By subtracting depreciation accruals associated with existing plant from the $3.7 billion of new investment over the five-year term, Dr. Selwyn arrived at the proposition that Ameritech Illinois only invested a "net" of $300 million in its network and, therefore, is not infusing new capital into its business. This proposition, AI contends, has no basis in any legitimate financial or economic theory. Much like any capital intensive company, AI claims, it incurs substantial depreciation expense which reflects both wear and tear as well as technological obsolescence. The relevant measure of Ameritech Illinois' investment in its network is the $3.7 billion and not the net figure cited by CUB. According to AI, the Commission ignored Dr. Selwyn when he advanced a similar argument in the 1994 proceeding.

The Attorney General and Cook County argue that Ameritech Illinois has failed to invest in those aspects of the network, which benefit POTS service noting, for example, that Project Pronto does little to benefit POTS customers. These arguments, AI contends, fundamentally misrepresent Project Pronto, which is not a "DSL project" but rather an overall network modernization program - which benefits all customers. In fact, AI points out, because the DSL aspects of Project Pronto are currently being deferred, Project Pronto now benefits only POTS services. (Tr. 1989-92).

CUB's Position

In CUB's view, the record evidence belies AI's claim that the plan has successfully facilitated any broad dissemination of technical improvements to all classes of ratepayers.

According to CUB, the Company presented no evidence to show that any technical improvements realized since 1994 would not have been achieved and spread over all customer classes if it had been operating under rate of return regulation. As pointed out by Dr. Selwyn, CUB claims that the $3.7 billion that AI invested over the term of the plan was not "new" investment, but was largely funded by ongoing depreciation charges and thereby represents the replacement of existing, "worn out" equipment rather than an infusion of new capital. Because it recorded a total of $3.4 billion in intrastate depreciation accruals over the 1995–1999 time period, AI actually made only $300 million in net investment according to CUB.

In any event, CUB claims, the $3.7 billion in investment claimed by the Company has not been sufficient to maintain basic service quality where AI did not target sufficient amounts into its basic local network, particularly to its outside plant, to ensure timely availability of network access – in new housing areas with high growth rates. According to CUB, executives at SBC, (AI's corporate parent), conceded that point to the investment community by blaming service quality failures on Ameritech's "lack of maintenance and capacity in the outside plant." (See, GCI Ex. 2.0 at 68-69). Neither AI witnesses Jacobs or Gebhardt, CUB notes, made mention of growth in the number of network access lines available to end users and, in addition, AI has chosen to suspend its "Project Pronto" deployment with respect to DSL service.

Commission Review of Premise No. 4

The whole point of Section 13-506.1 (a)(4) is that any technical improvements be disseminated to all classes of noncompetitive services ratepayers. The $ 3 billion commitment by AI, that we recognized and relied on for our 1994 plan approval, has been satisfied. There is nothing to indicate that this expenditure benefited only a particular group or segment of noncompetitive service customers. To the contrary, the upgrades under the plan appear to benefit all.

In any event, we would expect that the fulfillment of this obligation does not signal an end to the maintenance and improvements to AI's network. As long as the Plan continues in force, AI must ensure that all of its noncompetitive service customers have the requisite quality, and reliability of telecommunications services available to them. For its part, the Commission will look closely and speak directly to service quality issues in a latter part of this Order. At this juncture, and on the whole, while the Plan may not be any more appropriate in addressing this goal it is, at the least, equal to traditional regulation

Premise No. 5 - The Alternative Regulation Plan Enhances the Economic Development of the State.

The Development of and Prudent Investment in Advanced Telecommunications Networks That Foster Economic Development Of the State Should Be Encouraged. (Section 13-103(f)).

Authority: Section 13-506.1 (a)(5); Section 13-103 (f); Alt Reg Order at 183.

The Alt Reg Order

In 1994, the Commission determined, based on economic analyses presented in that proceeding, that there was a generally positive relationship between network modernization and economic development. It further noted that the Plan had certain features (freedom in depreciation and the removal of earnings constraints) that should induce the Company to investment in new technologies and provide new services.

AI's Position

In addition to the $3.7 billion investment previously outlined, Ameritech Illinois notes that it also spent millions of dollars opening its networks to competitors. It contends that customers benefit from the expanded choice of alternative service providers. It indicates further that the positive relationship between price regulation and network modernization, which the Commission relied on in 1994, has now been further validated by a NARUC/NRRI study based on empirical data from jurisdictions throughout the United States. (Am. Ill. Ex. 4.2, at 3-4). Accordingly, AI asserts, the Commission can conclude that the Plan has enhanced economic development in the State.

CUB and the Attorney General claim that Ameritech Illinois should have demonstrated that its network investment promoted economic development with more specificity. The relationship between network investment and economic development however, AI claims, can only be established at a broad, macroeconomic level. AI observes that the GCI's own witness, Dr. Selwyn testified that he was not expecting the Company to establish a linkage between specific network investments and economic development. While CUB also suggests that Ameritech Illinois was obligated to duplicate the economic analysis provided in the 1994 docket in this proceeding AI contends that nothing in the Commission's Alt Reg Order supports this claim.

CUB' s Position

CUB claims that the Company failed to provide a single example of economic development in this State that was a direct result of the AI price cap plan. The Company's assessment of its meeting the $3 billion commitment is suspect, CUB maintains, given that the majority of the investment represents replacement of worn equipment that, absent any evidence to the contrary, would have occurred under rate of return regulation. Thus, according to CUB, the Commission cannot assume that the plan has enhanced economic development simply because AI fulfilled its $3 billion investment commitment.

Commission Review of Premise No. 5

In 1994, the Commission concluded in the Alt Reg Order that there was a generally positive relationship between price regulation and network modernization, and between network modernization and economic development. We continue to believe in the worthiness of this proposition. In doing so, we take account of the investment promised and the Company's fulfillment of that commitment to find that the Plan has worked to enhance economic development in the state.

The Commission further observes that economic development depends on the availability of telecommunications service of sufficient quality and quantity offered by a variety of carriers. As such, we cannot completely disregard the investments AI made in opening its network to competitors. This is an important start and holds out promise for more customer choice and economic enhancement. As this effort continues, it is better aided overall by the Plan, than by traditional regulation. See generally, Section 13-801.

On the whole, the Plan remains a more appropriate form of regulation to foster the goals of economic development

Premise No. 6 - The Alternative Regulation Plan Permits Competition To Function As A Substitute for Aspects of Regulation When Consistent with Protections of Consumers.

Authority: Sections 13-103(b) and the Alt Reg Order at 184.

The Alt Reg Order

Under Section 13-103(b), the Commission must consider whether any alternative regulation plan will promote the legislative goal of allowing competition to substitute for certain aspects of regulation, where consistent with the protection of consumers. In its 1994 Order, the Commission concluded that the Plan would further this goal, because price regulation better reflects the operating freedoms and constraints faced by competitive companies and reduces the economic burden of regulation generally. (Alt Reg Order at 184).

AI's Position

While City witness Dr. Selwyn contended that the Plan failed because it did not actually further local competition as measured by competitive entry and competitors' market shares, AI maintains that this position has no basis in the statute, economic theory or regulatory policy. By its very terms, AI claims, Section 13-103(b) addresses the elimination of unnecessary regulatory oversight and constraints, not promoting competition per se.

AI explains that price regulation is fundamentally a retail plan, which governs the pricing of Ameritech Illinois' noncompetitive services to consumers. and it establishes the governance structure relative to retail service quality, network investment and financial performance. It is not, AI points out, a wholesale plan.

According to AI, price regulation plans do not, of themselves, either encourage or discourage the development of competition, except to the extent that they produce more efficient price signals to potential competitors. Indeed, AI notes, the original pioneering work on the merits of price regulation assumed a monopoly environment whereas now economists and regulators have concluded that price regulation is better adapted (than rate of return regulation) to the transition from monopolies to competition. In other words, AI claims, it makes no more sense to expect price regulation to promote competition than for rate of return regulation to do the same. In any event, AI maintains, it is uncontroverted that there is more competition today than there was in 1994.

AI further disputes Dr. Selwyn's claim that the Plan had actually harmed competition by allowing Ameritech Illinois to shift "costs out of its 'competitive' services and onto noncompetitive services -- including such bottleneck items as switched access and unbundled network elements...". (City Ex. 1.0 at 30-31). Nothing of the kind happened according to AI, and no party produced a shred of evidence to show that costs have been misallocated. Indeed, AI states, switched access rates declined more rapidly than any of Ameritech Illinois' other rates over the term of the Plan and were recently slashed by another $33 million as a result of Dockets 97-0601/0602. Further, AI contends, UNE rates were set at a very low level in 1997 based on TELRIC studies and they have not increased since then. In short, AI maintains, the Plan did not have and could not possibly have had a negative impact on any of these services.

AI notes GCI witness TerKeurst's claim that the Plan impeded competition, because the Company reclassified services as competitive and raised their prices. This argument, AI contends, posits the relationship between price changes and competition precisely backwards. According to AI, competitors are attracted to market segments and services where there is a reasonable opportunity to make a profit. Put another way by AI, price increases provide competitors with more, not less, incentive to enter.

Whereas the GCI/City continue to complain that residential competition has not developed sufficiently this is not, AI asserts, in anyway attributable to the Plan. According to AI, these parties ignore the numerous, complex factors which have contributed to the slow growth in residence lines served by competitors, i.e., low profit margins in the local exchange business relative to other CLEC business opportunities; strategic decisions by the IXCs; and unrealistic regulatory expectations. Despite these factors, AI claims that the CLECs have recently demonstrated a renewed interest in serving residence customers in Illinois.

AI further observes that the GCI's intense concern with the level of competition simply cannot be squared with its proposed $1 billion rate reduction, hundreds of millions of which result from imputed revenues and/or disallowances which bear no relationship to financial reality. If these adjustments were adopted, AI believes that they would disincent all competition, including efficient competition. While the GCI want both uneconomically low consumer rates and competition, AI contends that this is not how the marketplace works.

Staff's Position

Staff notes that the transition to competition has not, in fact, taken place nearly as quickly as the Commission apparently believed, and presumably hoped that it would. It contends, however, that this factor be given "limited consideration at most." (Staff Initial Brief at 31).

GCI/City's Position

The City contends that one of the State's major policy goals, i.e., promoting competition, has not been furthered by the Plan. It claims that the level of competition in the local exchange services market is extremely limited such that the vast majority of residential customers and a substantial number of business customers still lack meaningful competition. According to the City, the combination of the Plan's incentives, the Company's reaction to those incentives, and the ineffectiveness of service quality protections have acted to hinder the growth of competition.

The AG further asserts that the Plan has neither led to increased competition nor seen competition constrain monopoly profits.

Commission Review of Premise No. 6

We see no ~~casual~~ causal connection between the Plan and the furtherence/hinderence of competition in the way that GCI and City attempt to frame the issue. The Plan simply does not have such powers. The conclusory arguments presented do not consider or discuss all of the essential variables for the premise, including that the rates generated under the Plan in Illinois may have deterred incoming hopefuls seeking high profits. To be sure competition in the residential local markets has not opened as quickly or extensively as the parties or the Commission would have desired but we also cannot deny its growth. Nor can we conclude other than that this statutory goal, if properly construed, has been met.

Commission's Ultimate Overall Analysis and Conclusion:

In the Alt Reg order, the Commission rejected the view that it needs to find that each and every one of the policy goals set out in Section 13-103 and the considerations set out in Section 13-505.1 (a) either will be promoted, or will actually occur, if the plan is adopted. (Alt Reg Order at 180). The Commission interpreted subsection (b) (4) to mean that it must consider the policy goals set forth in Sections 13-103 and 13-506.1 (a), and, "based on the Commission's overall consideration," determine if the plan constitutes a more appropriate form of regulation." (Id.). If it makes this determination, the Commission reasoned, it has made the finding required by item No. 4 under subsection (b) of the statute. (Id.)

The Commission reaffirms its earlier construction of the statute, noting that no error in its interpretation was raised on appeal of the Alt Reg Order. Accordingly, we here consider whether the plan "overall" continues to constitute a more appropriate form of regulation in light of the goals and policies expressed in Section 13-103 and Section 13-506.1 (a).

This overall assessment must be sensitive to both time and circumstance. Back in 1994, when we set out our original premises, competition was in its early infancy stage. In the ensuing time, voice and data carriers have shaken up the market and competition for business customers has escalated. The Federal Telecommunications Act is spurring competitive activity in local markets and the wireless telephone is becoming commonplace. (See, for example, Section 13-712 (b) (1) which recognizes the wireless telephone as a viable alternative telephone service).

Within the context of these times, the Plan "overall" is meant to assure the availability, affordability, and quality of service for those customers without any competitive alternatives. There is noting in the evidence "overall" that convinces the Commission to abandon alternative regulation outright in favor of traditional regulation.

Overall, regulatory delay and costs have been reduced to the benefit of all concerned. Overall, alternative regulation "encourages" innovation and "promotes efficiency" far more than traditional regulation. Overall, alternative regulation facilitates the dissemination to all classes of ratepayers equally as well as traditional regulation.

We note that the General Assembly retained Section 13-506.1 in its recent review and rewrite. It further validated the viability of alternative regulation by modifying the Act to include provisions that direct certain activity by or related to carriers operating under alternative regulation. This action, prescribed in Section 13-103 (e) is another, and highly critical element, to be factored in our "overall" assessment.

We are mindful that the question of fair, just, reasonable and affordable rates appear as a consideration and as a goal under Section 13-506.1 (b)(4). We have, however, addressed this issue fully under Part III, Section A, above. So too, service quality, while certainly a goal under the Act, is also the direct subject of a separate finding i.e., Section 13-506.1 (b) (6), that the Commission was required to make and which it carefully reviews in another part of this Order. <u>See</u> Part III, Section F, below. If, however, we look at service quality "overall" for present purpose, we might easily conclude that while certain (but not all) of the Company's performance is clearly unacceptable, there are various means by which to correct behavior and still continue with the plan.

Thus, with respect to the comparison called for under Section 13-506.1 (b) (4), we find on this review, that "overall", the alternative regulation plan for AI continues to constitute a more appropriate form of regulation.

Our review continues.

EM/PAC:jt